

Metropolitan King County Council

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M E M O R A N D U M

DATE: November 1, 2005

TO: Metropolitan King County Councilmembers

FROM: Cheryle Broom, County Auditor

SUBJECT: Follow-up to 2004 Workers' Compensation Financial Audit

This letter discusses the results of our follow-up on the recommendations of the 2004 Workers' Compensation Financial Audit. In general, we find that most of the recommendations, including the most significant, have been implemented. In a few instances, recommendations were addressed in a different manner than that described in the text of the audit recommendations. In these instances, we find that the intent of the recommendation has been met.

Overview of the 2004 Workers' Compensation Financial Audit

The Workers' Compensation Financial Audit reviewed the financial condition of the Workers' Compensation Fund, how workers' compensation premiums were charged to county agencies, and the controls over financial transactions. Significant findings of the report included:

- The condition of the Workers' Compensation Fund was deteriorating. The fund balance was decreasing while unfunded future liabilities were increasing.
- The county did not report the full liability of the Workers' Compensation Fund in its financial reports.
- Risk classifications assigned to certain job titles appeared to be inappropriate.
- While controls over financial transactions were generally adequate, there was some room for improvement.

The report included eight recommendations intended to address these findings. The remainder of this letter discusses the report findings, recommendations, and actions taken to implement the recommendations in more detail.

Workers' Compensation Fund Balance

The audit found that the Workers' Compensation Fund balance was "significantly insufficient" to cover estimated claims liabilities. The fund balance was decreasing while the amount of unfunded liabilities was increasing. The amount of unfunded

liabilities had reached \$44.7 million as of 2003. The audit recommended the development of a multi-year plan to build up its reserves.

In the 2006 Proposed Budget, the Executive has developed a 20-year financial plan to increase the reserves of the fund balance to equal the amount of estimated claims liabilities. The financial plan and Executive's budget include a 28-percent rate increase in 2006, which would be sufficient to reverse the trend of declining fund balances, and begin to improve the ratio of fund balance to liabilities. Future rate increases in the plan are more moderate.

Based on our own financial model, we believe that a long-term approach to rebuilding the Workers' Compensation Fund balance is reasonable.

Financial Reporting of Workers' Compensation Liabilities

The audit found that the county's financial statements did not reflect the full future liability of current workers' compensation claims as estimated by an independent actuary, and recommended that the full liability be reflected in the Comprehensive Annual Financial Report (CAFR).

Beginning with the 2004 CAFR, the full liability of workers' compensation claims is reflected in the CAFR.

Calculation of Agency Premiums

The audit found that the methodology to distribute industrial insurance rates to agencies was generally fair, with some exceptions. The exceptions noted related to a few individual job classifications that were assigned incorrect risk classifications. Further, Transit and Wastewater Treatment Divisions did not use risk code classifications and job classifications to distribute costs to individual cost centers. The audit recommended that the workers' compensation program should:

- Review risk code classifications and make adjustments when necessary.
- Develop a written classification plan for assigning risk code classifications to various jobs or occupations.
- Consider calculating premiums for the Transit and Wastewater Treatment Divisions based on risk codes, job classifications, and hours worked (as is the case for all other county agencies).
- Use five years of claim loss experience when developing industrial insurance rates.

The following actions were taken by the Office of Safety and Claims Management to implement these recommendations:

- The Office of Safety and Claims Management initiated a process to correct coding errors in the payroll system, and compared risk codes assigned to job classifications to loss experience to make sure that risk classifications are appropriate. While a written risk classification plan was not developed as recommended, the actions that have been taken should provide further assurance that county job classifications are assigned to the proper risk code.

- Calculations of 2006 premiums for Wastewater Treatment and Transit Divisions did not use risk codes, job classifications, and hours worked as recommended. Instead, the Office of Safety and Claims Management provided cost data to the two divisions identifying workers' compensation costs by cost center. We believe this meets the intent of the recommendation.
- Five years of claims loss experience was used in developing industrial insurance rates for 2006.

Internal Controls Over Financial Transactions

The audit found that in general, internal controls over financial transactions were sufficient. A few deficiencies were noted and the report recommended that:

- The claims supervisor should review the register of warrants and the list of bills and invoices for payment and sign the document when this action is performed.
- The county should re-examine the need for a blanket employee fidelity bond.

The following actions were taken to implement these recommendations:

- The Claims Supervisor reviews payment lists. In addition, the check payment software has been enhanced so that it records who performs each step in the payment process, and one employee is not able to perform all of the payment steps and approvals.
- The Office of Risk Management purchased an insurance policy covering theft and faithful performance of duty by county employees.

Conclusion

Recommendations of the 2004 Workers' Compensation Financial Audit have been mostly implemented. In particular, the development of a financial plan to address the deteriorating condition of the Workers' Compensation Fund is important to address in a timely way. While improving the fund balance results in a substantial increase to agency industrial insurance rates in 2006, addressing the problem now could forestall the need for even more precipitous rate increases in the future.

cc: Ron Sims, King County Executive
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